

# **Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Mbizana Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Mbizana Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **Opinion**

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Mbizana Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

8. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

### **Material losses**

9. As disclosed in note 40 to the financial statements, material losses of R4,5 million were incurred as a result of electricity distribution losses.

### **Material impairments**

10. As disclosed in note 9, 10 and 12 to the financial statements, impairments of R10,4 million (2015: R3,7 million) relating to receivables from non-exchange transactions and R 4,8 million (2014: R 8,3 million) relating to receivables from exchange transactions and R0,9 million (2014: R0,9 million) relating to receivables from other exchange transactions were incurred as a result of irrecoverable debtors.
11. As disclosed in the statement of financial performance and note 28 to the financial statements, debt impairments totalling R3,7 million (2015: R3,5 million) were expensed.

### **Irregular expenditure**

12. As disclosed in note 43 to the financial statements, irregular expenditure of R2,6 million (2015: R3,5 million) were incurred due to the contravention of the supply chain management policy and legislation.

### **Unauthorised expenditure**

13. As disclosed in note 41 to the financial statements, the municipality incurred unauthorised expenditure of R113,9 million during the year. This unauthorised expenditure was mainly due to overspending for depreciation, asset impairment, non-cash disposals of PPE and for electrification-completed projects transferred to Eskom.

## **Additional matter paragraph**

14. The following additional matter paragraph will be included in our auditor's report to draw the users' attention to matters regarding the audit, the auditor's responsibilities and the auditor's report:

## Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly we do not express an opinion thereon.

## Report on other legal and regulatory requirements

16. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
  - Development priority 3: engineering services
  - Development priority 4: community services
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information.
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected development priorities.

## Additional matters

22. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected development priorities, I draw attention to the following matters:

## Achievement of planned targets

23. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year.

## Adjustment of material misstatements

24. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for development priority 3: engineering services and development priority 4: community services. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

## **Compliance with legislation**

25. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### Annual financial statements and annual report

26. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion

### Asset management

27. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

### Liability management

28. An adequate management, accounting and information system to account for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
29. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

### Expenditure management

30. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### Procurement and contract management

31. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of supply chain management regulation 17(a) and (c).

## **Internal control**

32. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on compliance with legislation included in this report.

### **Leadership**

33. Monitoring at an oversight level was not fully effective, as limited assurance was provided by the leadership with respect to the functioning of internal controls in the current year. A lack of adherence to policies and procedures, as well as the late implementation of the audit action plan, resulted in a breakdown in the credibility of information and the material misstatements identified in the financial statements. The action plan implemented in the current year did not address the control environment in a holistic, sustainable manner; but focused on prior year audit findings in a manner that managed the audit process at year-end. In addition, there was inadequate consequence management for sub-standard performance and transgressions, which set a tone of tolerance for poor financial and performance administration.

### **Financial and performance management**

34. There was an inadequate control environment at the municipality with ineffective daily and monthly processing and reconciliation of transactions relating to non-current assets, liabilities and disclosure items. Numerous misstatements existed in the submitted financial statements that were not identified by the municipality's system of internal control. In addition, certain underlying information was often not adequate to support the balances presented in the financial statements. The lack of a proper functioning control environment resulted in these deficiencies in the record management system and underlying records. Furthermore, compliance with laws and regulations was not monitored adequately, resulting in findings on compliance in the current year.
35. The annual performance report also included material misstatements (although corrected), due to a lack of oversight of the collection, collation and reporting of performance information.

### **Governance**

36. The audit committee held regular meetings as required by the MFMA. However, the audit committee's ability to provide assurance was limited due to the quality of the financial reports provided for its review. The audit committee also highlighted that the reporting culture within the municipality needed urgent management attention.

37. The audit committee met prior to the submission of the financial statements to review the adequacy, reliability and accuracy thereof. However, the review of the financial statements and compliance with laws and regulations was not adequate, as evidenced by the material misstatements identified.
38. Internal audit have discharged their responsibilities effectively by providing the audit committee with quality internal audit reports and providing support to the risk committee. However recommendations are not adequately responded to by some of the senior management team as the repeat findings were not properly addressed by management.

*Duduza - General*

East London

30 November 2016



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